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In the

Supreme Court of the United States

OCTOBER TERM, 1968

[redacted] 391

NATIONAL PLAN, INC., ET AL.,
Petitioners,

v.

CHURCH OF CHRIST OF ECORSE, MICHIGAN, ET AL.,
Respondents.

[redacted] PETITION FOR WRIT OF CERTIORARI [redacted]

GOLDEN, BURROW, POTTS & BOECKMAN,
WILLIAM BURROW,
2330 Republic National Bank Tower,
Dallas, Texas,
Attorneys for Respondents.

"'It requires but little appreciation * * * of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail' in every facet of the securities industry." Mr. Justice Goldberg in *SEC v. Capital Gains Bureau*, 375 U.S. 180, 11 Fed. 2d 237 (1963).

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OCTOBER TERM, 1968

No. 282

NATIONAL PLAN, INC., ET AL.,

Petitioners,

v.

CHURCH OF CHRIST OF ECORSE, MICHIGAN, ET AL.,

Respondents.

REPLY BRIEF TO PETITION FOR WRIT OF CERTIORARI AND CROSS-PETITION FOR SUCH WRIT

To Said Honorable Court:

Respondents, Church of Christ of Ecorse, of Ecorse, Michigan, Everman Church of Christ of Everman, Texas, Laurel Street Church of Christ of San Antonio, Texas, Church of Christ of South Haven, of South Haven, Michigan, Vaughn Hill Church of Christ of Wood River, Illinois and West End Church of Christ of St. Louis, Missouri, file this Reply Brief to the Petitioners' Writ of Certiorari, and Cross-Petitioners', Ecorse and Everman Churches, file their Cross-Petition for a Writ of Certiorari to review the case below.

REPLY BRIEF

Opinion Below and Jurisdiction

The Petition correctly refers to the opinion below and the grounds on which the jurisdiction of the Court is invoked.

Statutes and Regulations Involved

Applicable Statutes:

Section 10(b) of the Securities Exchange Act, 15 U.S.C. 78j:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange— * * *
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Section 15 of the Exchange Act, 15 U.S.C. 780:

> "(a) (1) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, unless such broker or dealer is registered in accordance with subsection (b) of this section."

"(a) (8) No broker or dealer registered under section 15 of this title shall, during any period when it is not a member of a securities association registered with the Commission under section 15A of this title, effect any transaction in, or induce the purchase or sale of, any security (otherwise than on a national securities exchange) unless such broker or dealer and all natural persons associated with such broker or dealer meet *such specified and appropriate standards with respect to training, experience, and such other qualifications* as the Commission finds necessary or desirable." (Italics ours)

Appellees were not members of NASD (Tr. 64).

"(c) (1) *No broker or dealer shall* make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to *induce the purchase or sale of*, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, *by means of any manipulative, deceptive, or other fraudulent device or contrivance.* The Commission shall, for the purposes of this subsection, by *rules and regulations* define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

"(2) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, in connection with which such broker or dealer *engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation.* The Commission, shall, for the purposes of this paragraph, by *rules and regulations* define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative and such quotations as are fictitious." (Italics ours)

Section 29 of the Securities Exchange Act, 15 U.S.C. 78cc:

"*Every contract made in violation of any provision* * * * and *every contract* * * * the performance of *which involves* the violation of, or *the continuance of any relationship or practice in violation of*, any provision of this chapter or any rule or regulation thereunder, *shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract* * * *.

"Nothing in this chapter shall be construed * * * to afford a defense to the collection of any debt or obligation * * * by any person who shall have acquired such debt, obligation, or lien in good faith for value and *without actual knowledge of the violation* * * *" (Italics ours)

Applicable Rules:

Rule 10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

"Rule 15c1-2(a). Fraud and Misrepresentation

"*(a)* The term '*manipulative, deceptive,* or other fraudulent device or contrivance,' as used in section 15(c) (1) of the Act, is hereby defined to include *any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.*" (Italics ours)

"Rule 15c1-4. Confirmation of Transactions

"The term 'manipulative, deceptive, or other fraudulent device or contrivance,' as used in section 15(c) (1) of the Act, is hereby defined to include any act of any *broker or dealer* designed to effect with or for the account of a customer any transaction in, or to induce *the purchase or sale* by such customer of, any security (other than United States Tax Savings Notes, United States Defense Savings Stamps, or United States Defense Savings Bonds, Series E, F and G) unless *such broker or dealer,* at or before the completion of each such transaction, gives or *sends to such customer written notification disclosing* (1) whether he is acting as *a broker for such customer, as a dealer for his own account,* as a broker for some other person, or as a broker for both such customer and some other persons; and (2) in any case in which he is acting as *a broker for such customer* or for both such customer and some other person, either the name of the person from whom the security was purchased or to whom it was sold for such customer and the date and time when such transaction took place or the fact that such information will be furnished upon the request of such customer, and the source and amount of any commission or other remuneration received or to be received by him in connection with the transaction." (Italics ours)

"Rule 15c2-4. Transmission or Maintenance of Payments Received in Connection with Underwritings

"*(a)* It shall constitute a 'fraudulent, deceptive or manipulative act or practice' as used in section 15(c)(2) of the Act, for *any broker or dealer* participating in any distribution of securities, other than a firm-commitment underwriting, to *accept any part of the sale price of any security being distributed unless:*

"(1) the money or other consideration received *is promptly transmitted to the persons entitled thereto; or*

"(2) if the distribution is being made on an 'all-or-none' basis, or *on any other basis which contemplates that payment is not to be made to the person on whose behalf the distribution is being made until some further event or contingency occurs, (A) the money or other consideration received* is promptly deposited in *a separate bank account, as agent or trustee for the persons who have the beneficial interests therein,* until the appropriate event or contingency has occurred, and then the funds are promptly transmitted or returned to the persons entitled thereto, or (B) all such funds are promptly transmitted to a bank which has agreed in writing to hold *all such funds in escrow for the persons who have the beneficial interests therein* and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred." (Italics ours)

To procure a Broker-Dealer license, Section 15(b) of the Exchange Act and the Rules thereunder prescribe detailed application requirements, examinations, and financial worth for registration, and reports and regulation after a license is granted.

Questions Presented

Respondents feel that Petitioners' statement of the questions presented is incorrect, and state them as follows:

(1) Do churches (who entrust their securities to their building contractor who said he would "place" them, but instead misappropriated them and secretly sold them to a "fence" at an excessive prohibitive discount, and seller and buyer were, unknown to the churches, broker-dealers and not registered in violation of the Securities Exchange Act, and combined to divert the proceeds to another conspirator, knowing the churches had not been paid) have a cause of action to declare the sales void under Section 29, without proof that the violations of the Act were the cause of the losses? (Respondents feel the violations were the cause).

(2) Are the issuers limited to rescission, or may they have the full damages for which they prayed?

(3) Is the defense of *pari delicto* available to the churches, where the bonds were held in trust by the contractor to deliver them to no person until payment was received and the proceeds transmitted to them, because a statement on the bonds said they were paid for, when the buyer knew they were not, and when the churches did not know the contractor was a broker-dealer?

STATEMENT OF THE CASE

Respondents consider that Petitioners' Statement of the Case contains inaccuracies. The first sentence is fragmentary and is supplemented and corrected by our fuller statement below. It is more correct to say, as to their third sentence, that Paden did not remit any of the proceeds of the sale of the bonds to any of the churches (R 190). As to the

second paragraph, it is questionable whether Paden ever acted as a principal. He testified he did not (R 184). We think the fifth and sixth paragraphs do not correctly state the rulings of the Court of Appeals. The next to the last paragraph does not, in our opinion, state the fundamental question as no one has any authority to violate the law, and the question is really whether the loss should fall on Respondents who violated no law or on Petitioners who confessedly violated the law. Under the circumstances, we submit for clarity and necessary detail the following statement of our own:

This is a facet of the full case alleged in the Second Amended Original Complaint by the 22 Plaintiff churches (of which 6 are involved in this Petition) which is of a single conspiracy to defraud under Sections 10(b) of the Securities Exchange Act of 1934 and Rule X-10b-5 thereunder, involving also violations of other Acts and Rules. The general scheme was to loot insurance companies by acquiring them with church bonds which were unpaid for, with representations to some of the co-conspirators that they would pay the churches for the bonds with the companies' premium income.

Details as to the facts of this conspiracy will be found in the Complaint at pages 300 and following of the transcript. The conspiracy itself is alleged in Art. IV (R 297).

Glen V. Paden, a church building contractor formerly of good repute, allegedly obtained for World Oil and Gas Corporation of Delaware and other Defendants pursuant to the scheme more than five million dollars in bonds from

churches for whom he was building, usually through the guise separately to each church that he "would place" the bonds. A chart of those so obtained, with the dates, the more than three million dollars of bonds recovered, and the $1,874,695 of bonds still outstanding, appears at pages 302 and 304 of the transcript.

Among those obtained by Paden were $555,650 from the seven churches involved in the hearing below, $215,750 of which he disposed of to Petitioners. It was stipulated at the hearing: "With the exception of West End Church * * * the bonds were handed to Mr. Paden with the understanding and instructions that *he would not deliver possession of them to any person until he received payment of face value for them, which he was to forward promptly to the church involved*" (R 105).

Mr. Paden and Petitioners understood that Paden was an agent to place all of these bonds (R 68, 184). He testified he did not own any of them (R 184) and that he did not tell Petitioners he owned any (R 33). His employees, however, told the Ecorse and Everman churches Mr. Paden was buying the bonds. Petitioner National Plan, Inc., through its sole manager and controlling officer, Petitioner Knox (R 29, 70) purchased the $215,750 in bonds involved, $8500 at 10% discount below face value, $22,000 at 15% discount, and later $150,750 at 16.51% discount, and $34,500 at 16.88% discount.

Petitioners paid for the above $150,750 of bonds with checks to another Defendant, World Oil and Gas Corporation. It is not controverted that Mr. Paden told Petitioners: that the churches had not been paid for any of the bonds (R 179-180, 198); that the checks to World Oil was a loan for which World Oil was to pay a prohibitive penalty by absorbing the discount for the short time use of the money, until repaid by Paden and World Oil to the churches when the money would be needed for construction (R 56, 179-180, 182, 195, 196, 199); and that this money from the sale was to help them "get started" (R 200) (on the scheme). Although Petitioners considered Mr. Paden the agent for the churches (R 68), they did not confirm the transactions to the churches (R 76) or contact them in any way for months (R 73-75).

It is conceded that both Paden and the Petitioners were Broker-Dealers, and unlicensed in violation of the Securities Exchange Act. The churches remained in complete ignorance of these transactions and of the transactions of each other, wanted their money, and would have objected if they had known (R 208-9). Petitioners, however, knew of Paden's vast transactions (R 185), but the churches did not and none of them knew that its contractor was a Broker-Dealer (R 107, 117-118, 130, 135, 149, 152, 164).

Petitioner Knox had been an automobile salesman until less than a year before these transactions began and had had no experience in securities (R 59-60). Petitioners

effected actions in bonds for churches throughout the country (R 29, 30, 61, 62). The Petitioner company owned $185,400 in bonds when Mr. Knox bought it in 1964 (R 60) and disposed of them. It began buying and selling other bonds on its own account, after Mr. Knox purchased it, at least as early as January 1965, and bought a total of $271,120, including those of the Respondents by July 28th, 1965. Petitioners bought the Appellants' bonds for resale, sold $82,700 of them, and held $156,800 for sale (R 20, 55, P1. Ex. 1). The financial statement is weak (P1. Ex. 1); all the purchases were made 100% on borrowed money (R 66), with the bonds pledged to a bank (R 15)—an innocent purchaser. At the time of hearing, Petitioners still had no Broker-Dealer License, though advised by the SEC and their own lawyers that they should have one (R 51-52).

Respondents, though gullible and lulled by Petitioners and the other Defendants, became more and more impatient, discovered the scheme, and brought this lawsuit January 8, 1966. The Petitioner company intervened the following summer asking for declaratory judgment that its bonds were good against Respondents. Respondents replied, impleaded Petitioners as Defendants in the main suit as in violation of Sections 10 and 15 of the Exchange Act, and Rules X10b5, 15c1-2, 15c1-4, and 15c2-4 thereunder, and asked for restoration of the bonds or damages (R 315-318, 285-292).

Reasons For Not Granting Petitioners' Writ

Sec. 2 of the Securities Exchange Act (15 U.S.C. 78b) states that transactions in securities are "affected with a national public interest * * * making it necessary to provide for (their) regulation and control * * * to require appropriate reports and to impose requirements necessary to make such regulation and control reasonably complete and effective". Moreover, most transactions occur over the counter, and four-fifths of all bond transactions such as those involved in this case occur there (*Loss*, Sec. Reg. (2d Ed.) 1284-1286). Where there is no "registration" by the Brokers and Dealers who conduct these operations there can be no "appropriate reports" and no "requirements necessary" for "regulation and control". Where there is such a black market for stolen securities, thefts and frauds abound. Congress provided the remedy for failure to register by Sec. 29 of the Act (15 U.S.C. 78cc) and the Court of Appeals has enforced it in this case as to several churches whose bonds were misappropriated, and we trust this Honorable Court will uphold that decision.

The Court below was of the opinion that the huge loss should fall upon the Petitioners who violated the Act and not upon the Respondents who did not violate it. It held that Respondents' remedies were not limited to rescission but they could have their full damages, and held by implication certainly that Mr. Paden, a fiduciary trusted to obey the law, was without authority from Respondents to violate the law.

ANSWER TO PETITIONERS' ARGUMENT AMPLIFYING ITS REASONS

1. It has been pointed out above that the Petitioners' statement of this question as to causal relation is inaccurate, and we phrase it, we think, properly on page 7 above.

The whole argument of Petitioners is tied to the past. They tried the case, as appears from the record, on the theory that the securities laws did not apply and that it was a case under the Negotiable Instruments Law. The Trial Judge agreed, holding that because the securities were exempt from registration so also were those who traded in the securities, and, apparently, held further that since there was no common law fraud, there was no Securities Exchange Act fraud. We think that in their argument on causal relations, Petitioners hold to the old arguments.

The distinguished Judge Charles Clark held in *Goldstein v. Groesbeck*, 142 F. 2d 422, (2 Cir., 1944, Cert. Den., 323 U.S. 737) that a public utility holding company which refused to register under the Public Utility Holding Company Act of 1935 (15 U.S.C. 79), had to account to its subsidiaries for its profits under service and construction contracts. Sec. 26(b) of that Act (15 U.S.C. 79z(b)) is almost identical as the Court says, at 427, with Sec. 29 of the Exchange Act (15 U.S.C. 78cc). Judge Clark said that "Sec. 26 is incomplete, is not ineffective unless it is considered to authorize recovery by the operating companies."

The *Goldstein* case was one of overriding public concern, as is this case in that the maintenance of an honest market and an end to frauds and swindles such as have occurred here is a matter of great importance to public welfare. To require that all Broker-Dealers dealing in securities should be licensed, controlled, made to take the training and held to the standards of honesty and accounting that registration requires, as Congress has done, is similar to the requirement of registration of public issues and, for that matter, to the requirement that a bank be chartered. To provide a remedy by voiding the contracts of the violators is no more severe than to provide a remedy for false and misleading statements or to make an unchartered bank return money. Without that remedy the vast over the counter market cannot be controlled because, just as Mr. Justice Clark pointed out in *J. I. Case v. Borak*, 377 U.S. 426 (at 432), 12 L. Ed. 2d 423 (at 428), "the possibility of civil damages * * * serves as a most effective weapon". No government commission can do so without the supplement of private action; and who can say that Respondents' losses would have occurred had there been only an honest market. Where but at a bucket shop could $215,750 of securities be sold with the dealers "spread" in the form of a prohibitive discount such as condemned in the famous *Shingle* case *Hughes & Company v. S.E.C.*, 139 F. 2d 434 (2d Cir. 1943, Cert. Den. 321, U.S. 786)?

Furtherfore, there was the failure of Petitioners to confirm to Respondents, and their combination and conspiracy with Paden in diverting the proceeds of the sale, which

we argue in our own Cross-Petition below. It seems to us that there was sufficient causation, and that even if there were not, the statute is specific in its statement that the contract shall be void.

We disagree with the Petitioners' argument that the claim is one in tort. Vitiating a contract is a claim in contract and not tort. We, therefore, think Petitioners' argument citing the cases of *List v. Fashion Park, Inc.*, 340 F. 2d 457, (2d Cir., 1965, no App. for Cert.); *Vine v. Beneficial Finance Company*, 374 F. 2d 627, (2d Cir., 1967, Cert. Den. 389 U.S. 970); *Smith v. Bear*, 237 F. 2d 79 (7th Cir., 1956, no App. for Cert.); and *Boone v. Baugh*, 308 F. 2d 711 (8th Cir. 1962, no App. for Cert.) are confusing but not helpful. They are all Rule X10b5 cases and, of course, all fraud cases which, even though the rule expands and liberalizes common law fraud to meet the intricate needs of today, still sound in tort. The Ben Jack Cage case, *Hooper v. Mountain States*, 282 F. 2d 195, (5th Cir., 1960, Cert. Den. 365 U.S. 814) was also a X10b5 case and went the other way and held, apparently, that in cases of mammoth fraud, causation is self-evident.

Loss, Sec. Regs. 1765-6, discusses the question of reliance under X10b5 cases.

Ours is not that kind of a case but a statutory contract case. It is logical and a harmonious theory that causation is not essential under the restricted Section 29 contract cases but is an essential element under the crime-tort fraud cases. Thus, similarly under Sec. 12(2) of the 1933 Act (15

U.S.C. 771) in sales with misleading statements, causation is not necessary, *Loss*, Sec. Regs. (2d Ed.) 1702, *Woodward v. Wright*, 266 F. 2d 108, (10th Cir. 1959, no App. for Cert.)

Petitioners' reference to Sec. 28(a) (15) U.S.C. 78bb) does not seem relevant as the section is only to prevent double damages, which are not sought here.

The references to the Congressional Record on pages 12-14 of Petitioners' Application are not, in our opinion, material as the debate concerned Sec. 18 of the Exchange Act (15 U.S.C. 78r), which concerns applications and reports to the Commission, and specifically provides for reliance and good faith.

2. Petitioners' argument that Respondents are limited to the remedy of rescission only is not, in our opinion, sound. We asked specifically for restoration of the bonds and for full damages (R 317-318). Furthermore, it is in direct conflict with the holding of *Hooper v. Mountain States*, supra and with the case of *J. I. Case Company v. Borak*, supra where the Court states "We, therefore, believe that under the circumstances here it is the duty of the Courts to be alert to provide such remedies as are necessary to make effective the Congressional purpose" (377 U.S., at 433; 12 Law Ed. 2d, at 428). Furthermore, how could the churches restore what they never received, and which Petitioners made it impossible for them to receive by conspiring and combining to divert the proceeds to another Defendant?

3. Respondents contend that the question as stated by Petitioners is not a fair one on the record and that the

correct question is that set forth under (3) on page 7 above. On the facts in the case *pari delicto* is simply not an issue. As stated on page 10 above, with specific references to the record, Respondents did not know Paden was a Broker-Dealer and it was stipulated that Paden was not to deliver the bonds to anybody until payment was received (R 105). There is no evidence that any church knew of transactions of the other churches. The delivery of the bonds under such a trust to Paden could not constitute any falsity or misrepresentation. Furthermore, the Court below correctly held that the statement as immaterial, as it was uncontradicted that the Petitioners knew that the bonds were not paid for (R 179-180, 198). Furthermore, as *Hooper v. Mountain States*, supra held, *pari delicto* would not be a defense (*Loss*, Sec. Regs. (2d Ed.) 1797-1804).

RESPONDENTS' CROSS-PETITION FOR WRIT OF CERTIORARI

Respondents, Ecorse and Everman Churches, hereby file their Cross-Petition for review for Writ of Certiorari. To avoid confusion the Cross-Petitioners will hereafter be referred to as "the Churches" and Cross-Respondents as "National".

Time for Cross-Petition

By order of Mr. Justice Hugo Black of July 10, 1968, the time for filing this Cross-Petition was extended until August 10, 1968.

Formal Requisites

The formal matters required by Rule 40, the Statutes and Regulations Involved and the Statement of the Case as to the facts are set forth hereinabove on pages 2-11, and by the Petitioners in their application, all of which is incorporated herein by reference.

Questions Presented for Review

1. Are the Churches precluded from recovery by lack of privity on the contract theory under Sec. 29?

2. If so, may they recover under the crime-tort theory for National's violation of SEC Rule X15c1-4 by failure to confirm, or under Rule X-15c2-4 for National's combining with Paden in his misapplication of funds?

3. Or, may they recover under the crime-tort theory for National's combination and conspiracy in the combination and conspiracy with Paden in the misapplication of funds in violation of Rules X-10b-5 and 15c1-2?

ARGUMENT

1. Granting, as on this record must be done, that all the churches have been swindled and that National violated the law, and granting, as must also be done under the *Borak* case, supra, that the "Federal Courts have the power to grant all necessary remedial relief", it does not seem fair that these two churches should be denied relief by use of the fiction "privity". The only difference between their situation and that of the others is that Paden's employees

told them he was buying the bonds. As specific references to the record on page 9 above show, both Paden and National thought as to these as to the other churches, that he was only an agent to place the bonds. The record shows the Ecorse bonds were received by Paden May 13th and sold to National the next day, and the Everman bonds received by him on July 16th with $19,000 sold on the 19th and the other $21,000 on the 27th. This immediacy and the apparent agency of Paden ought, in common sense, to be sufficient privity, because National's information and actions were exactly the same as with the churches where recovery is allowed. We see nothing in any case we can find, or in any definition of privity, including those in 33 *Words and Phrases* 810, Supp. 250, requiring more.

Yet *Loss*, at page 1759, thinks that for recovery under a contract theory, privity is required, and *Natkin v. Exchange Bank*, 342 F. 2d 675 (7th Cir. 1965, No App. for Cert.) talks about lack of privity. The holding, however, is not in point. The bank Defendant there was not at fault in any way whatsoever, taking securities pledged in violation of the margin requirements without any knowledge of the violation. National here is violating the law and we have not even joined, as a party, the bank to which he pledged the securities. The *Natkin* decision would have been the same without the privity dictum.

Furthermore, Section 29(b)(2), while perhaps not specifically applicable here, shows that the Act does intend recovery against a Defendant "not being a party to

such contract" with knowledge of the violations. In any event, we contend there was sufficient privity under the contract theory and, if not, the fiction ought to be abolished, as has been done anyway by what Professor Loss describes as "implied liability" under the crime-tort theory (on the same page 1759).

2. Here we contend on the second question that National is on the horns of a dilemma. Under the provisions of Rule X15c1-4, if Knox, its sole manager, understood Paden was only an agent, he was bound to confirm the transactions to his principal. This is the clear provision of the rule and the Commission so interprets it (*In the matter of Alex Smith*, 30 S.E.C. Reports 13 (1946)). He did not confirm, in the case of Ecorse, from May 14th to November 1st, and in that of Everman from July 19th until the latter date.

The other horn of the dilemma, and this is the one the proof shows, is that if he knew Paden was also a Broker-Dealer he knew that Paden was violating Rule 15c2-4. The proceeds were not being promptly transmitted to the Churches who were entitled thereto or put in a bank account in trust for them as the Rule requires. Knowing of Paden's vast transactions (R 185) and that Paden was an agent (R 68, 184), did not own the bonds (R 184), that the Churches had not been paid (R 179-180, 198) and of its own huge purchases from Paden, National was bound to have known Paden was a Broker-Dealer.

By the proviso that was added to Sec. 29(b) by the amendment of 1938, violations of these rules were excluded from express liability under Sec. 29, that is to say, under the void contract theory. The Court below felt that the rules were thus not applicable but this is, we think, a *non sequitur*. The rules would have no meaning whatsoever if there were not some penalty for violation. Recovery can and should be allowed under the crime-tort theory that the disregard of the command of a statute is a wrongful act and a tort as stated in another connection in *Texas & Pacific Railway v. Rigsby*, 241 U.S. 33, 39: "This is but an application of the maxim, *Ubi jus ibi remedium.*" This is what Professor Loss describes as "implied liability" (1763-1771) and was first advanced in S.E.C. Rule X10b-5 cases in *Karton v. National Gypsum*, 69 F. Supp. 512 (E.D. Pa. 1946) and culminated in the *Borak* case supra.

Under the crime-tort theory all difficulties of privity disappear (*Loss*, 1763-71, *Hooper v. Mountain States*, supra; *Errion v. Connell*, 236 F. 2d 447 (9th Cir., 1956); *Deckert v. Independence Shares Corp.*, 311 U.S. 282, 85 L. Ed. 180 (1940)). The language of the latter case was quoted with approval in the last paragraph of 377 U.S. at 433 in the *Borak* case. The old common law concepts, according to Mr. Justice Goldberg, are not suitable to present day transactions in the intricate securities field (*SEC. v. Capital Gains Bureau*, 375 U.S. 180 11 L. Ed. 237 (1963)).

Moreover, under the crime-tort theory, problems of causation disappear, not only as to the two church Cross-Peti-

tioners but as to the other four churches involved as well. The chain of causation is full and complete. It is as follows:

(1) Possession secured by Paden illegally.

(2) Unlawful sale to unregistered Broker-Dealer at black market discount, who knew bonds were not paid for and Paden to be the Churches' agent.

(3) Sale was without authority to sell by Seller to Buyer without authority to buy, because of violations of the Securities Acts.

(4) Wrongful combination and conspiracy in misappropriation with a loan at exorbitant interest to another conspirator, knowing that prompt payment was not being made to the Churches entitled thereto.

(5) Causing liability of the Churches to innocent purchasers.

Failure to confirm could be inserted in lieu of the knowing participation and conspiracy to misappropriate, although proof of the conspiracy in violation of Rule X15c2-4 is in the record.

3. The facts stated and argued in 1 and 2 above also constitute violations of Rules X10b-5 and X15c1-2(a). These violations were alleged by the Churches (R 289, par. VII; 297, par. IV) but were not argued in the Trial Court because of a procedural tangle, nor in the Court of Appeals because reversal was sought for the precedural error that the issues on these two rules were not tried. The Court of Appeals has held, however, that they were tried, and the Churches are now, therefore, at liberty to argue that National's actions violated these Rules.

The ready market afforded the admitted swindler Paden by National, the excessive discounts paid on an increasing scale as time went by, the lack of registration, the knowledge that the bonds were not paid for, the loan of the proceeds to another conspirator who would pay exorbitant interest, the knowledge that the proceeds were not being transmitted to the Churches, the operations on 100% borrowed money, the immediate pledge of all the bonds, and quick resale at or near face value, may not constitute common law fraud as the Court found, but in the light of all the cases cited herein, are a part of one of the largest "frauds or deceits" on record in this country and constitute violations of the rules cited.

WHEREFORE, Respondents pray that the Petitioners' Application for the Writ be denied and that Cross-Petitioners' Application be granted.

GOLDEN, BURROW, POTTS & BOECKMAN,
WILLIAM BURROW

Wm. Burrow

Attorneys for Respondents and Cross-Petitioners

August 7, 1968

Copy this day mailed Receiver, Securities & Exchange Commission, *amicus curiae*, and Attorney for Petitioners.

WILLIAM BURROW